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Office of the Attorney General



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Reply to:
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Attorney General's Office
P.O. Box 20207
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February 25, 2003

Hon. Sara Kyle, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

Re: Attorney General's Response to Proposal from BellSouth
Docket No. 03-00060

Dear Chairman Kyle:

Enclosed is an original and fourteen copies of the Attorney General's Response to Proposal from BellSouth, Docket No. 03-00060. Copies are being furnished to counsel of record for interested parties.

Sincerely,

A handwritten signature in cursive script, reading "Joe Shirley".

JOE SHIRLEY
Assistant Attorney General

cc: Counsel of Record
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**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

**IN RE: BELL SOUTH
TELECOMMUNICATIONS, INC.
TARIFF TO INTRODUCE
WELCOMING REWARD PROGRAM
(TARIFF NO. 03-017)**

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DOCKET NO. 03-00060

ATTORNEY GENERAL'S RESPONSE TO PROPOSAL FROM BELL SOUTH

Comes now Paul G. Summers, the Attorney General and Reporter of the State of Tennessee, through the Consumer Advocate and Protection Division of the Office of Attorney General (hereinafter "Attorney General")¹, pursuant to the Tennessee Regulatory Authority ("TRA") *Notice of Schedule* dated February 20, 2003, and hereby files this *Attorney General's Response to Proposal from BellSouth* in the above-styled matter.

I. INTRODUCTION

Pursuant to the *Notice of Schedule*, BellSouth Telecommunications, Inc. ("BellSouth") filed a proposal on February 21, 2003, regarding its tariff to introduce the "2003 Welcoming Reward Program" ("Proposed Tariff"). BellSouth requests that the Proposed Tariff replace its second-revised tariff filed on February 19, 2003 ("Revised Tariff"). BellSouth filed the Revised Tariff to conform the terms of its retail offering to the TRA's decision allowing the original tariff to become effective, provided that no termination liability charges be assessed for cancellation of service after 90 days. *See Order Allowing Tariff to Go Into Effect* at pp. 4-5 (Feb. 14, 2003).²

¹ This filing is submitted under the authority of Tenn. Code Ann. § 65-4-118.

² Director Ron Jones dissented from this decision. *See Dissent of Director Ron Jones to Order Allowing Tariff to Go Into Effect* (Feb. 20, 2003).

BellSouth's Proposed Tariff alters the Revised Tariff as follows:

1. Extends the enrollment period from May 2, 2003, through May 30, 2003;
2. Makes the retail services provisioned through the Revised Tariff available for resale at the established, wholesale discount rate;
3. Reinstates termination liability charges for termination of service after 90 days;
4. Requires service to be retained through the 4th billing period; and
5. Changes the timing in the delivery of the \$100 incentive to either the 4th or 5th billing period.

All other terms and conditions of the Proposed Tariff remain essentially the same as the Revised Tariff. BellSouth believes that the Proposed Tariff adequately resolves all concerns regarding this particular promotion. For the reasons stated hereinafter, the Attorney General does not.

II. MOST OF THE ISSUES RAISED BY THE ATTORNEY GENERAL HAVE NOT BEEN RESOLVED BY THE REVISED TARIFF OR THE PROPOSED TARIFF

On January 31, 2003, the Attorney General filed its *Complaint and Petition to Intervene* in this matter ("Attorney General Petition"). In order to further set out the allegations made in the Attorney General Petition, on February 11, 2003, the Attorney General filed its *Memorandum in Support of Convening a Contested Case Proceeding* ("Attorney General Memorandum").

Through these filings, the Attorney General raised the following issues with regard to BellSouth's original tariff:

1. Whether the tariff violates BellSouth's duty to offer for resale at established wholesale discount rates any telecommunications service that it provides to telecommunications customers who are not telecommunications carriers in violation of 47 U.S.C. § 251(c)(4)(A) and related rules and orders of the Federal Communications Commission ("FCC") and the TRA. *See* Attorney General Petition at pp. 2-3, ¶¶ 6-7; Attorney General Memorandum at pp. 3-6;

2. Whether the tariff unjustly discriminates among telecommunications customers in violation of Tenn. Code Ann. §§ 65-4-122 and 65-5-204(a). *See* Attorney General Petition at p. 3, ¶ 8; Attorney General Memorandum at pp. 6-11;
3. Whether the tariff impermissibly creates a price squeeze in violation of Tenn. Code Ann. §§ 65-5-208(c) and 65-4-123. *See* Attorney General Petition at p. 4, ¶¶ 9-10; Attorney General Memorandum at pp. 11-12;
4. Whether the tariff unreasonably locks customers into long-term service commitments in violation of Tenn. Code Ann. §§ 65-5-208(c) and 65-4-123. *See* Attorney General Petition at pp. 3-4, ¶¶ 9-10; Attorney General Memorandum at pp. 12-13;
5. Whether the tariff unreasonably restricts resale of retail services in violation of 47 U.S.C. § 251(c)(4)(B) and Tenn. Code Ann. §§ 65-5-208(c) and 65-4-123. *See* Attorney General Petition at p. 2-4, ¶¶ 6-7, 9-10; Attorney General Memorandum at p. 14; and
6. Whether the tariff unreasonably inflates customer acquisition costs of competing carriers in violation of Tenn. Code Ann. §§ 65-5-208(c) and 65-4-123. *See* Attorney General Petition at p. 4, ¶¶ 9-10; Attorney General Memorandum at pp. 14-15.

These six issues were raised relative to BellSouth's original tariff. Both the Revised Tariff and the Proposed Tariff revise certain provisions of the original tariff. Accordingly, it is necessary to consider the effect of these revisions on the original issues and, specifically, to determine whether any of these issues is mooted or otherwise mitigated by the changes.

As summarized hereinbelow, the Revised Tariff significantly mitigates the Attorney General's concerns with respect to issue no. 4 regarding long-term service commitments, and the Proposed Tariff renders moot issue no. 1 regarding resale at wholesale discount rates. None of the other original issues is mooted or significantly mitigated by any of the changes made in the Revised Tariff or the Proposed Tariff.

Issue No. 1 — Resale at Established Wholesale Discount Rates. BellSouth initially took the position that its tariff does not have to be made available for resale at the wholesale discount rate

because it is a short-term promotion. The Attorney General alleged that the tariff is a long-term offering because, in order to secure the tariff's incentives, the customer must agree to a one-year service commitment. The changes made in the Revised Tariff do not affect this issue. However, the Proposed Tariff adds a provision that makes the tariff's promotional rates available for resale. Accordingly, issue no. 1 is not addressed by the Revised Tariff, but this issue is mooted by the Proposed Tariff.

Issue No. 2 — Unjust Discrimination. BellSouth initially took the position that the tariff's discrimination between so-called new business customers and other business customers is justified by competition, the Competitive Necessity doctrine, and/or the short-term promotion exemption to its resale obligations. The Attorney General alleged that none of the reasons proffered by BellSouth justifies the discriminatory pricing created by its tariff, and that, on its face, no such justification exists. Neither the Revised Tariff nor the Proposed Tariff addresses this issue.

Issue No. 3 — Impermissible Price Squeeze. BellSouth initially took the position that its tariff does not constitute a price squeeze because, in part, competing carriers may compete through UNEs, and its competitors can afford to offer their own special deals to customers. The Attorney General alleged that the tariff's promotional rates for BellSouth's retail customers are less than BellSouth's wholesale rates for its competitors; and the Attorney General further alleged that the tariff creates an impermissible price squeeze because BellSouth's competitors cannot effectively resell the promotional rates offered by the tariff on their initial attempt to win customers from BellSouth. Neither the Revised Tariff nor the Proposed Tariff addresses this issue.

While it is true that the Proposed Tariff facially makes the promotional rates available for resale, resellers of basic business local service still cannot effectively resell these rates because

BellSouth's existing customers are not eligible for service under the terms of the Revised Tariff or the Proposed Tariff. It is these ineligible, existing customers that are the primary focus of a reseller's marketing plan. Accordingly, in most instances, the wholesale price for resellers is greater than the retail price for BellSouth's retail customers under either tariff.

Issue No. 4 — Unreasonable Long-Term Service Commitments. BellSouth initially took the position that customers were not locked into unreasonable, long-term service commitments because prior TRA decisions in this regard are inapposite to the instant tariff. The Attorney General alleged that the combination of front-end incentives offered through a comparatively short enrollment period, coupled with long-term service agreements loaded with back-end termination liabilities, unreasonably locks customers into long-term service commitments. The Attorney General further submitted that these structural aspects of the instant tariff were determined to be anti-competitive in a prior docket. *See Order Denying Tariff*, TRA Docket No. 99-00936 (Nov. 7, 2000).

The Revised Tariff eliminates termination liability charges for cancellation of service after 90 days. Because back-end termination liabilities are an important element of the Attorney General's allegation, the changes made in the Revised Tariff significantly mitigate the Attorney General's original concerns relative to issue no. 4. On the other hand, the Proposed Tariff reinstates these back-end termination charges. Accordingly, issue no. 4 once again arises under the terms of the Proposed Tariff.

Issue No. 5 — Unreasonable Restrictions on Resale. The Attorney General alleged that the tariff constitutes an unreasonable restriction or condition on resale because the tariff's promotional rates cannot be effectively resold to most of the resellers' new customers due to BellSouth's narrow construction of customer eligibility requirements. Only so-called new business

customers of BellSouth, which are very likely to be the current customers of its competitors, are eligible for such rates. New customers of the reseller, which are very likely to be the current customers of BellSouth, are ineligible. The resale provision added to the Proposed Tariff does not address customer eligibility requirements, and essentially constitutes a veil to mask the anti-competitive nature BellSouth's retail offering.

BellSouth has a duty to offer for resale at wholesale discount rates any bundled services that it provides at retail to noncarrier subscribers. Federal law exempts only short-term promotions from the incumbent carrier's wholesale discount requirements. *See Memorandum Opinion and Order*, FCC 99-386, 14 FCC Rcd 21,579 at ¶ 47 (Dec. 23, 1999). Section 251(c)(4) makes no general exception for promotional or discounted offerings, including contract offerings to new customers. *See Local Competition Order*, FCC 96-325, 11 FCC Rcd 15,499 at ¶ 948 (Aug. 8, 1996). If it were otherwise, an incumbent carrier could "avoid the statutory resale obligation by shifting their customers to nonstandard offerings, thereby eviscerating the resale provisions of the 1996 Act." *Id*

Accordingly, there is no "new customer" exemption to BellSouth's resale obligations under federal law. Because BellSouth's improper construction of customer eligibility requirements is not addressed by either the Revised Tariff or the Proposed Tariff, issue no. 5 remains a concern of the Attorney General.

Issue No. 6 — Unreasonable Inflation of Customer Acquisition Costs. The Attorney General alleged that BellSouth's tariff unreasonably inflates a competitor's customer acquisition costs because its application essentially requires the competitor to win the customer from BellSouth twice. This is so because competitors cannot effectively resell the promotional rates to their targeted customer group — i.e., BellSouth's existing customers. Thus, in order to continue serving the

customer, the competitor must respond to BellSouth's tariff by winning the same customer a second time. This issue has not been addressed by either the Revised Tariff or the Proposed Tariff.

III. BELLSOUTH'S REVISED TARIFF IS A LONG-TERM RETAIL OFFERING AND, ACCORDINGLY, THE PROMOTIONAL RATES OFFERED THEREIN MUST BE MADE AVAILABLE FOR RESALE

The *Notice of Schedule* directs the parties to address the following two issues:

- A. Whether BellSouth's tariff is a short-term or long-term promotion; and
- B. Whether the promotional discount offered in the tariff should be available for resale.

Both of these issues essentially center on whether BellSouth must offer for resale the retail services provisioned through the Revised Tariff at the 16% wholesale discount rate established by the TRA in the Avoidable Costs proceeding. *See Final Order*, TRA Docket No. 96-01331 (Jan. 17, 1997). The *Notice of Schedule* also directs the parties to discuss the price-floor analysis as it relates to BellSouth's Revised Tariff. The statutory price floor for incumbent local exchange carriers is established in Tenn. Code Ann. § 65-5-208(c).

If the TRA accepts BellSouth's Proposed Tariff, these issues will be mooted because it clearly provides that the promotional discounts offered therein are available for resale. The Attorney General nonetheless responds to the TRA's *Notice of Schedule* hereinbelow.

A. THE REVISED TARIFF IS A LONG-TERM OFFERING

The Revised Tariff's provision that requires customers to commit to a one-year term of service in order to receive the tariff's incentives prevents the tariff from being a short-term promotion for resale purposes. The FCC clearly defined a short-term promotion as one that involves rates that will be in effect for no more than 90 days. *See* 47 C.F.R. 51.613(a)(2). Pursuant to the

FCC's rule, incumbent carriers such as BellSouth are not required to make short-term promotions available for resale at the wholesale discount rate. On the other hand, long-term offerings whose promotional rates are in effect for longer than 90 days must be made available for resale at the wholesale discount rate. *See* 47 U.S.C. § 251(c)(4)(A).

BellSouth cannot have its cake and eat it too. Either the Revised Tariff is a short-term promotion, in which case the promotional rates are in effect for no more than 90 days; or the tariff is a long-term promotion, in which case the promotional rates are in effect for greater than 90 days. The Attorney General submits that if the promotional rates are in effect for less than 90 days, the customer must have the capability to cancel the promotion after 90 days without penalty and without exposure to legal liability. Otherwise, the effect of the tariff's incentives are not temporary and, accordingly, have become an integral part a long-term arrangement.

In this case, there is a simple and direct relationship between the Revised Tariff's incentives and the one-year service agreement — no incentives; no one-year agreement. The only inducement for the customer to sign the agreement is the incentives offered by the tariff. Thus, the incentives and the one-year service agreement are inextricably combined into one deal for one year of basic business local service. The Revised Tariff therefore is a long-term offering for resale purposes.

B. THE PROMOTIONAL RATES MUST BE MADE AVAILABLE FOR RESALE

Because the Revised Tariff's promotional rates are in effect for greater than 90 days, it is a long-term offering rather than a short-term promotion. Accordingly, the Revised Tariff's retail rates, inclusive of any promotional discounts given to retail customers, must be made available for resale at the established wholesale discount rate. *See* 47 U.S.C. § 251(c)(4)(A); 47 C.F.R. § 51.613(a)(2);

Local Competition Order, FCC 96-325, 11 FCC Rcd 15,499 (Aug. 8, 1996); and *Final Order*, TRA Docket No. 96-01331 (Jan. 17, 1997).

C. THE REVISED TARIFF INTRODUCES A PREDATORY-PRICING ISSUE INTO THIS CASE

A predatory-pricing issue arises under the Revised Tariff because a retail customer may be able to purchase three months of basic business local service for \$19.10 per line (($\39.70×3) - \$100.00). This price could be well below the statutory price floor, especially in light of the fact that the tariffed rate is \$119.10 per line ($\39.70×3). In this instance, the discounted price is only sixteen cents on the dollar of ordinary retail, which is a price more akin to the value of distressed assets.

To prevent the anti-competitive practice of predatory pricing by incumbent carriers, the General Assembly chose to enact a statutory price floor. Thus, Tenn. Code Ann. § 65-5-208(c) provides in part:

Effective January 1, 1996, an incumbent local exchange telephone company shall adhere to a price floor for its competitive services . . . The price floor shall equal the incumbent local exchange telephone company's tariffed rates for essential elements utilized by competing telecommunications service providers plus the total long-run incremental cost of the competitive elements of the service . . . The authority shall, as appropriate, also adopt other rules or issue orders to prohibit . . . predatory pricing . . . or other anti-competitive practices.

Predatory pricing is generally defined as the pricing below an appropriate measure of cost for the purpose of eliminating competition in the short run and reducing competition in the long run. *See Ghem, Inc. v. Mapco Petroleum, Inc.*, 850 S.W.2d 447 (Tenn. 1993). By implementing the statutory price floor, the General Assembly specified the appropriate measure of cost to be used in a predatory-pricing case involving competition in Tennessee's telecommunications markets.

If a customer is permitted to terminate service after three months without incurring any further liability, the incumbent carrier's retail price must be above the statutory price floor over this minimum period of service in order for the carrier to comply with Tenn. Code Ann. § 65-5-208(c). In this case, a customer may be able to purchase three months of basic business local service through the Revised Tariff for only 16% of its normal, tariffed rate. The practical effect of such an offering is elimination of short-run competition and reduction of long-run competition in the basic business local service market. Accordingly, if an 84% reduction in BellSouth's ordinary tariffed rate for basic business local service is below the statutory price floor for this service, the Revised Tariff constitutes illegal, predatory pricing.

IV. SUMMARY OF ISSUES

BellSouth's Revised Tariff may be currently in effect.³ BellSouth requests approval from the TRA to replace the Revised Tariff with the Proposed Tariff. The Attorney General alleges that both tariffs are illegal on several grounds. In order to clarify its position and concerns with respect to each tariff, the Attorney General submits the following list of issues identified hereinabove and in prior filings, and connects each of the issues to the respective tariffs. The issues are:

1. Whether the tariff violates BellSouth's duty to offer for resale at established wholesale discount rates any telecommunications service that it provides to telecommunications customers who are not telecommunications carriers in violation of 47 U.S.C. § 251(c)(4)(A) and related rules and orders of the FCC and the TRA;
2. Whether the tariff unjustly discriminates among telecommunications customers in violation of Tenn. Code Ann. §§ 65-4-122 and 65-5-204(a);

³ At the Authority Conference held on February 18, 2003, the TRA rejected BellSouth's first revision to the original tariff because it did not comport with the TRA's February 3rd decision to allow the original tariff to become effective provided that no termination liability charges be assessed for cancellation of service after 90 days. BellSouth's second revision to the original tariff, which is the Revised Tariff, appears to comply with the TRA's February 3rd decision, as expressed in the *Order Allowing Tariff to Go Into Effect* entered on February 14, 2003.

3. Whether the tariff impermissibly creates a price squeeze in violation of Tenn. Code Ann. §§ 65-5-208(c) and 65-4-123;
4. Whether the tariff unreasonably locks customers into long-term service commitments in violation of Tenn. Code Ann. §§ 65-5-208(c) and 65-4-123;
5. Whether the tariff unreasonably restricts resale of retail services in violation of 47 U.S.C. § 251(c)(4)(B) and Tenn. Code Ann. §§ 65-5-208(c) and 65-4-123;
6. Whether the tariff unreasonably inflates customer acquisition costs of competing carriers in violation of Tenn. Code Ann. §§ 65-5-208(c) and 65-4-123; and
7. Whether the tariff violates the statutory price floor in violation of Tenn. Code Ann. § 65-5-208(c).


Based on the foregoing, the Attorney General submits that the following issues relate to the Revised Tariff: Nos. 1, 2, 3, 5, 6, and 7; and, the following issues relate to the Proposed Tariff: Nos. 2, 3, 4, 5 and 6.

V. CONCLUSION

Identified herein are six controverted issues with respect to the operation of BellSouth's Revised Tariff, and five controverted issues with respect to its Proposed Tariff. The Attorney General submits that, in light of the allegations made herein and in previous filings, each of these issues presents legitimate concerns about the illegality of BellSouth's retail offering under a reasonable interpretation of cited authorities. Therefore, the Attorney General respectfully requests that the TRA convene a contested case proceeding to evaluate the issues raised herein, and to hear our concerns regarding the prime issue of whether BellSouth's retail offering is illegal.

RESPECTFULLY SUBMITTED,

PAUL G. SUMMERS, B.P.R. #6285
Tennessee Attorney General


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Assistant Attorney General

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Attorney General's Response to Proposal from BellSouth was served on parties below via facsimile and U.S. Mail, postage prepaid, on the 25th day of February, 2003.

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